NATIONAL SECURITY COUNCIL MEETING

February 2, 1982

Agenda

1. Clarification of the Scope of the December 30, 1981 Sanctions Involving Oil and Gas Equipment Exports to the Soviet Union

Clarification of the Scope of the December 30, 1981 Sanctions Involving Oil and Gas Equipment Exports to the Soviet Union

Since the imposition of expanded foreign policy controls on oil and gas equipment exports to the Soviet Union on December 30, 1981, there has been disagreement within the government as to the scope and interpretation of those controls. It is urgent that the matter be resolved quickly, so that the Commerce Department can publish definitive regulations.

Basically, the controversy involves whether the sanctions were intended to cover controlled subsidiaries of U.S. companies abroad and whether they were intended to cover foreign licensees of U.S. companies.

In an attempt to obtain interagency agreement on this matter, a meeting was held on January 27, 1982 in the Situation Room consisting of representatives of the Department of State (Stoessel), Defense (Carlucci), Commerce (Olmer), CIA (Inman), Office of the Vice President (Murphy) and Ambassador Kirkpatrick. A paper prepared by the Commerce Department (Tab A) was used as the basis for discussion. Subsequently, a more extended Commerce Department paper on the legal background was received (Tab B).

Unfortunately, it was not possible to get unanimous agreement on the questions of the application of the sanctions to subsidiaries and/or licensees. Defense, CIA, Commerce, USUN, Office of the Vice President and NSC agree that the sanctions should be interpreted to include subsidiaries and licensees, for the following reasons:

-- Without such application, the sanctions will be ineffective in slowing or stopping development of the Siberian pipeline.

-- Not applying the sanctions to subsidiaries will be seen as penalizing U.S. companies, U.S. workers and U.S. exports rather than the Soviets.

-- Even if after prolonged litigation, extension of the controls is declared invalid in other countries, by that time great damage will have been done to the pipeline project because of continued uncertainties. This is particularly true of the banking community.

-- Not applying the sanctions to subsidiaries and licensees will be perceived as making our original response very weak and increase the likelihood of a longshoremen's boycott of grain shipments as well as encouraging media and political criticism.

The State Department opposes interpretation of the sanctions to include subsidiaries and licensees (Tab C), at least at this time, for the following reasons:

-- We are still making efforts to get our allies to agree to similar measures.

-- Extension of the controls would be extremely divisive in the alliance, where economic conditions and unemployment are very bad.

-- Our legal authority in the case of licensees is murky and in both cases will be hotly contested by our allies.

-- Our allies consider our use of the Polish crisis as an excuse to attack the pipeline to be unfair.

-- The longshoremen have agreed to delay any action for the time being.

The Treasury Department agrees that any controls that could be effective should be imposed, even if not supported by our allies. It is, however, concerned that legal actions in court rulings in allied countries could make the controls totally unenforceable.

Attachments

Tab A	Commerce Paper
Tab B	Commerce Paper on Legal Background
Tab C	State Paper

ISSUES RELATING TO EXTENSION OF OIL AND GAS CONTROLS

Introduction

The President announced sanctions on December 29, 1981 against the USSR that broadened oil and gas controls to include refining and transmission equipments. The controls prevent the export or reexport of U.S. origin commodities and technology to the USSR. Commerce Department specialists maintain that the broadened controls require additional extension to block or delay the construction of the West Siberian Pipeline. The proposed extensions are:

I. Barring of all "U.S. Persons" (controlled foreign subsidiaries of U.S. corporations) from exporting oil and gas equipments to the USSR regardless of U.S. content, and

II. Barring the export to the USSR of foreign products based on U.S. technology without U.S. components.

By further extending the controls, the U.S. will have a significantly higher probability of delaying or blocking the pipeline; our allies are expected to object strongly, however. New controls would also blunt criticism by the press and the AFL-CIO. On the other hand, these extensions could cause long-term US business losses as foreign customers turn in the future to non-US suppliers of technology and components. Decisions need to be taken regarding the extension of the new controls.

Two other issues have surfaced since December 30th. Several foreign governments (U.K., FRG, and Italy) and companies have informally requested that signed contracts should not be affected by the sanctions and that components already shipped from the U.S. should not require reexport authorizations. Turbine rotors supplied by G.E. to firms in Western Europe are affected by both these issues. Several hundreds of millions of dollars and thousands of jobs are involved. Decisions should be taken on how to handle requests by governments to make exceptions to our sanctions.

Present Coverage

The expanded controls cover:

- Exports or reexports of U.S. origin goods (regardless of physical location)

- Products of technology exported after December 30, 1981

- Reexport of foreign produced commodities containing U.S. origin components

Issues for Decision

I. Should the U.S. prevent U.S. foreign subsidiaries from selling controlled commodities?

Legal Authority: Legal authorities exist under the EAA to assert control over U.S. subsidiaries.

Discussion: Although authority exists to control subsidiaries, it has been used only once (Levi's uniforms for the Moscow Olympics). If this action is taken, the major contracts affected include Dresser Industries' French subsidiary ($30 million contract for the sale of 21 compressors) and Howmet Turbine Components Corporation's U.K. and French subsidiaries ($4 million contract under negotiation). This option provides the President significant leverage to delay or even block the pipeline. Allied reaction is expected to be strong but this step is necessary if we are to stop compressor sales. It may be possible to get voluntary allied cooperation to prevent sales of relevant equipment. Voluntary compliance should be discussed before action is taken.

Decision: Include all U.S. foreign subsidiaries under the sanctions (consult with allies to solicit voluntary agreement before actually implementing.)

Yes _____ No _____

II. Should the U.S. assert control over foreign made products of U.S. technology which was transferred before December 30, 1981?

Legal Authority: No precedent exists under the export regulations for such an application (Carter Administration controls on oil and gas production and exploration equipment were applied prospectively). It can be done, however; but on tenuous legal grounds.

Discussion: Several companies in Europe use General Electric's technology to produce gas turbines, and have signed contracts with the USSR to supply the pipeline's 41 compressor stations. No deliveries have been made. At the time of the technology transfers, no license nor written assurances were required. The G.E. Manufacturing Associates include AEG-KANIS Turbinehfabrick (West Germany), John Brown Engineering (U.K.), and Nuovo Pignone (Italy). Alsthom-Atlantique (France) also has a license arrangement with G.E. to produce turbines. Lastly, Rolls Royce (U.K.) manufactures a turbine for which a coupling shaft is a product of U.S. technology, as is the compressor itself.

Soviet Union and option I is implemented, the President

woul[illegible]lock the pipeline. The allies argue that we should only include products of U.S. technology which is transferred after December 30, 1981, and that to cover earlier technology is retroactive application of U.S. law.

Decision: Include in our sanctions foreign-made products of U.S. technology which was transferred before December 30, 1981? (Consult with Allies to solicit voluntary agreement before actually implementing.)

Yes _____ No _____

III. Grant reexport authorization for controlled components already in Europe?

Legal Authority: The EAA and present regulations clearly require a reexport authorization from Commerce

Discussion: Over the past two years, G.E. and other companies have exported to Western Europe components that didn't require the government's prior approval but that now require a validated license because of the sanctions the President imposed on December 30th. For example, John Brown has 6 rotors, AEG Kanis has 2 rotors, and Nuovo Pignone 14. Each rotor costs $1.5 million. Ambassador Louis has suggested granting these authorizations to ease tensions between the U.S. and our allies, since without the U.S. rotors the companies would lose over $500 million in business (some of which would be covered by insurance) and result in substantial layoffs. The situation is especially acute in the U.K.

By granting this exception, the ultimate fate of the pipeline will not be affected. The pipeline requires 125 turbines and this would allow only those currently in Europe (22) to be sent to the U.S.S.R. Rotors for the rest of the turbines would require export licenses to leave U.S. shores. Granting an exception, however, could be used as a bargaining chip to induce allies to take independent steps to stop the pipeline. This action would be viewed as a dilution of the sanctions that were imposed on December 30th.

Decision: Grant exception by issuing reexport authorization while negotiating with allies for them to take independent steps to delay the pipeline.

Yes _____ No _____

IV. Grant export Licenses to G.E. to export 103 rotors to fulfill present contracts?

Legal Authority: EAA and present regulations clearly require validated licenses to export turbine rotors.

CONFIDENTIAL

Discussion: Contracts or Letters of Intent (Nuovo Pignone) exist to sell 125 gas turbines for the pipeline. G.E. will supply the rotors while final assembly will be in the U.K., FRG, and Italy. With U.S sanctions, the rotors can't be supplied thereby preventing the foreign companies from delivering over $500 million of turbines. Substantial lay-offs would result, especially in the U.K. The respective governments are expected to request exceptions to the sanctions. While alternatives to G.E. gas turbines exist, they are either less reliable, more costly or impractical. Granting the exceptions would be viewed as substantially diluting the sanctions imposed on December 30th and invite criticism in the press. Agreeing to this option would ensure that the pipeline is built.

We could, however, use an exception for present contracts to entice our allies to take independent actions (withdrawal of loan guarantees) to delay or block the pipeline. The negotiations, if started, should be low-key. Also, if exceptions are granted, we should grant licenses for all signed contracts in the U.S. and abroad for oil and gas equipments. U.S. industry would strongly object if we allowed exceptions only for one U.S. firm.

Decision: Grant exception by issuing export licenses for rotors after successfully negotiating with allies to take independent steps to block pipeline (withdrawal of loan guarantees)? /Note: Granting this exception means that we should examine -- with presumption of approval -- all signed contracts./

Yes_____ No_____

Approved For Release 2008/08/18 : CIA-RDP84T00109R000100080022-9

LEGAL AUTHORITY ISSUES RELATING TO OPTIONS FOR THE EXTENSION OF OIL AND GAS CONTROLS

Option 1. Should the United States prevent U.S.-controlled foreign firms from selling controlled commodities of foreign origin?

Legal Authority:

The legal issue posed by the use of this option is whether there is authority under the Export Administration Act to control exports by U.S.-controlled foreign firms. The EAA provides authority to control exports from foreign countries that are sent by "any person subject to the jurisdiction of the United States." (EAA §§ 5(a) (national security) and 6(a) (foreign policy) ; 50 U.S.C.A. App. §§ 2404(a) and 2405(a)). This phrase could be interpreted to include U.S. owned or controlled foreign companies. There is no requirement under the statute that U.S. origin goods or technology be involved.

The authority was added to the EAA in 1977, with legislative history that it was to be used sparingly in view of international repercussions. The effect of that 1977 amendment has been "to broaden the potenital reach of peacetime, non-emergency foreign policy controls to exports by foreign subsidiaries of all products and data (not merely strategic) to all destinations (not merely the embargoed nations and other Communist countries)." (Abbott, Linking Trade to Political Goals: Foreign Policy Export Controls in the 1970s and 1980s, 65 Minn. L. Rev. 739, 847 (1981). During consideration of the EAA in 1979, the Senate acknowledged that the arguably broadened effect "may not have been considered adequately by the Congress at the time the provision was adopted;" however, it withdrew an amendment that would have eliminated the 1977 authority "pending further study." (S. Rep. No. 169, 96th Cong., 1st Sess. 11 (1979)). The authority to date has been exercised only once. Its use was pinpointed to provide a contractual defense for nondelivery of foreign manufactured Levi's uniforms for Moscow Olympics participants (15 C.F.R. § 385.2(d) (1981)).

Controls on exports by U.S.-controlled foreign firms have been imposed by Treasury under the authority of the Trading with the Enemy Act (50 U.S.C.A. App. § 5(b)). The same jurisdictional reach is in the International Emergency Economic Powers Act (Id. § 1703(a)(1). In practice, the extraterritorial reach of the Treasury-administered controls, such as the Cuban embargo, has been cut back over the years in the face of foreign government protests and challenges (Compare 31 C.F.R. § 515.541 (1975) with id. § 515.559 (1981)). The more recent Iranian Assets

Control Regulations did not require licenses for exports of goods and technology by non-banking U.S.-controlled foreign firms (31 C.F.R. §§ 535.207, .429, and .430 (1980)).

The legislative history and past practice of administering similar controls under analogous statutes raises the issue of whether such option would be effective in light of predictable negative foreign reactions. Consideration of the issue should involve not only likely diplomatic protests and non-cooperation of foreign courts but also the use by a foreign government of statutes that would block U.S. enforcement actions of suspected unauthorized exports. Foreign statutes would also subject persons in the foreign country to penalties for making or for responding to U.S. inquiries. A foreign government could also use these laws to prohibit firms doing business in its territory (including U.S.-controlled foreign firms) from complying with U.S. exports controls (See e.g., Protection of Trading Interests Act, 1980, c. 11 (United Kingdom); Law 80-538, (1980) J.O. 1799 (France). It should be noted that, as in the Fruehauf case, a foreign government has the power to finesse that claim of jurisdiction by simply having a receiver appointed which would end "U.S. control" (Fruehauf Corp. v. Massardy, (1965) La Semaine Juridique II 14274 (bis) (Cour d'appel, Paris), (1965) Gaz. Pal. II 86, 5 Int'l Legal Mat'ls 476, reprinted in A. Lowenfield, Trade Controls for Political Ends § 3.3 at 81 (1977).)

The United States could counter these potential foreign reactions by suspending the U.S. export privileges of foreign firms violating U.S. controls (15 C.F.R. §§ 387.1(b), 388.3 (1981)). This suspension can be achieved through administrative hearings and would not require the gathering of evidence abroad. This U.S. sanction might induce a foreign company that is dependent upon continued access to U.S. goods and technology to persuade its government to moderate its response to U.S. controls, however, such unilateral action on our part could well lead to serious trade problems in the future.

Option II. Should the U.S. assert control over foreign-made products of U.S. technology which was transferred before December 30, 1981?

Legal Authority:

The legal issue posed by the use of this option is whether the Export Administration Act (EAA) provides the authority for subsequently controlling the export from a foreign country of a foreign product of U.S. technology, if, at the time the U.S. technology was exported from the United States, there were no controls on the technology or its foreign direct product.

The EAA provides authority to license the export of goods or technology "subject to the jurisdiction of the United States" (EAA §§ 5(a), 50 U.S.C.A. App. § 2404(a) (national security); and id. 6(a), id. § 2405(a) (foreign policy)). The term is not defined in the statute or its legislative history.

Under the Export Administration Regulations (EAR), the Department has exercised this authority to assert control over reexports of U.S. goods (15 C.F.R. § 374.2 (1981)) and technology (id. § 379.8) through conditions imposed by general regulation or specific licensing conditions at time of export from the United States, i.e., while the goods or technology are still under U.S. territorial jurisdiction. Such reexports are subject to controls existing at the time of reexport. Thus, the regulations "tie a string" on the U.S. goods or technology, reserving the right to bar later the reexport of an item to a destination to which it could have been freely exported when it left the U.S.

Such assertion of control over foreign transactions does not fit easily into internationally recognized principles of jurisdiction, but a "defensible" case can be made for the international legality of conditions of extraterritorial control imposed at the time of export. The ultimate issue under this option is whether the EAR provision controlling the export of foreign products of U.S. technology (id. § 379.8(a)(3)) can be interpreted or amended to control foreign produced turbines or compressors on the basis of U.S. technology exported prior to the imposition of the December 30, 1981 controls. Section 379.8(a)(3) contains no express reservation of the right to subject such foreign products to U.S. controls in effect at the time of export from the foreign country, as is done in the previously mentioned EAR reexport sections. In addition, no precedent exists under the EAR for such an application of these controls (Carter Administration controls on oil and gas production and exploration equipment were applied prospectively).

The legal grounds for what amounts to retroactive control after technology is already abroad and outside U.S. territorial jurisdiction are tenuous. There is a very high risk that any attempt to interpret or amend the product of technology provisions to have them reach back to cover foreign exports involving technology exported prior to the new controls would not be sustained if challenged in U.S. courts. As discussed in Option I, if these controls were imposed, foreign countries could block enforcement by statutes or other legal means.

Option III. Should the United States grant reexport authorization for controlled U.S. components of foreign products already in Europe?

Legal Authority:

The legal issue posed by use of this option is whether the EAR can be modified or interpreted to restrict the export of foreign products containing U.S.-origin parts or components which are incorporated in the foreign product before such a restriction is imposed?

The EAR provision restricting the export or reexport of foreign end-products containing U.S.-origin parts and components (15 C.F.R. § 376.12 (1981)) attempts to subject the foreign transaction to U.S. control after the export from the United States. But that provision is less clear than the EAR's reexport provisions (discussed in Option II) concerning when, after export, such control could be exercised. Section 376.12 merely provides that U.S.-origin parts and components used abroad to produce a foreign-made end product are "subject to the export control laws of the United States."

On its face, the explanatory note following section 376.12 subjects the parts and components to a system of specific or general authorization in effect at the time "of incorporation abroad . . . in a foreign-made end product that will be exported to another country. This explanation takes account of business realities since a foreign producer would want to know before incorporating U.S. parts in his product whether U.S. controls would permit export to a particular destination. However, the breadth of the phrase "subject to the export control laws of the United States" permits a wide range of interpretations including one permitting the exercise of U.S. controls, after incorporation of the U.S. parts, at the time of export.

There is a risk of successful challenge in U.S. courts if the United States asserts controls over foreign products at the time of export from the foreign country (i.e., after incorporation of U.S. parts). However, a reasonable case can be made that the regulations already reach such transactions. As a matter of practice, the Office of Export Administration exercises control over U.S. parts and components in foreign end products at the time of export or reexport from a foreign country, rather than at the time of incorporation.

Approved For Release 2008/08/18 : CIA-RDP84T00109R000100080022-9

SECRET

DEPARTMENT OF STATE

Washington, D.C. 20520

Subject: Political Implications of Extraterritorial Application of US Export Controls

During the January 27 meeting at the NSC under Mr. McFarlane's chairmanship, Acting Secretary Stoessel noted that the extraterritorial application of US export controls to foreign subsidiaries and licensees would be strongly resisted by the Europeans and would cause serious political problems with our Allies. This memorandum supplements the points which the Acting Secretary made at that time.

Many governments view our claim to jurisdiction over subsidiaries as contrary to international law and as an affront to their sovereignty and economic independence. Even governments which tend to be much closer to our assessment of the Polish situation, such as the United Kingdom (which has domestic legislation which could block some US embargo measures), would be much less likely to cooperate with us in an effective sanctions program were we to provoke a dispute through the extraterritorial application of our export controls to subsidiaries. Such a dispute over issues of national sovereignty and the allegiances of transnational companies would distract us from our efforts to reach agreement in dealing with the developments in Poland.

The Department of State believes that the benefits to be gained from the extraterritorial application of our controls to US subsidiaries and licensees in the case of the gas pipeline are outweighed by the political costs of a major dispute with key Allies over this issue. We would obtain virtually no additional leverage over the pipeline at the cost of considerable ill will. Rather than being seen as a sign of US determination to deal effectively with the Soviet Union in light of the repression in Poland, this move would be seen as an affront to the sovereignty of the European countries involved. If we pressed our case, this could well lead to further efforts by the European governments involved to restrict US investment or to circumscribe the actions of European subsidiaries of US companies.

The conflict with key European Allies and Canada over such extraterritorial application of US export controls goes back for many years. It reached a high point during the early 1960's over US embargoes to Cuba and China. Jurisdictional

SECRET

SECRET

conflicts led several of our Allies to pass or threaten special legislation to block locally incorporated US subsidiaries from honoring US requirements. Indeed, in one case in the 1960's, the French courts took over the operation of a US subsidiary of Fruehauf to prevent its compliance with the embargo on China trade.

Attempting to force the Western European subsidiaries of a US company such as Dresser (France) to refuse to fulfill its contract for equipment to be installed on the West Siberian pipeline would place the subsidiary between conflicting US and French policies, laws or requirements and could invite renewed French action to thwart our controls.

In the case of licensees, the situation is complicated by different types of licensing arrangements involved. We have US legal authority to impose controls over products based on US technology transferred after December 31, 1981, but legal authority over products based on technology previously transferred is difficult to enforce effectively. Even if we could place legally effective extraterritorial controls reaching all firms which plan to use GE turbine technology for exports for the gas pipeline, they would not reach Rolls Royce which can supply turbines derived from the RB-211 jet engine. Furthermore, bringing foreign licensees under the controls umbrella, would pose serious political and economic problems. Since World War II, Europe has been dependent on the US for substantial imports of advanced industrial technology. If the US were now to reach out and control retroactively European products made from US technology transferred prior to the imposition of our own export controls, a large percentage of Europe's industrial output could be affected. The Europeans would undoubtedly view such a tactic as a heavy-handed attempt to force European countries into embargoing exports to the USSR. Moreover, in the longer run this would undercut the attractiveness and competitiveness of US technology in Europe for years to come. They would find such an action intolerable. The result would be that it would create a great deal of ill will with very questionable results.

CONFIDENTIAL

UNITED STATES DEPARTMENT OF COMMERCE
International Trade Administration
Washington, D.C. 20230

JAN 29 1982

MEMORANDUM FOR LIONEL H. OLMER
Under Secretary for International Trade

FROM: W. H. Morris, Jr. WHM
Assistant Secretary
for Trade Development

Lawrence J. Brady
Assistant Secretary
for Trade Administration

PREPARED BY: JBrougher (EWT)/DStein (EWT)/DSchlecty (TA)

SUBJECT: Economic Cost to U.S. of Extraterritorial Application of Oil and Gas Controls

The extraterritorial application of oil and gas controls will have an immediate impact on a number of American firms. We estimate that subsidiaries of American firms would lose about $200 million annually over the next 2-3 years in signed or projected contracts for delivery of goods to the Soviet Union. This cost would be added to the impact of the December 30 controls, i.e., loss of perhaps $150-250 million annually in exports and reexports to U.S.S.R. Soviet orders for Western oil and gas equipment and pipe totalled about $7.4 billion in 1976-80.

In the longer term the cost could be substantially more. In Western Europe, Japan, and elsewhere potential purchasers of technology and equipment and manufacturing partners could be motivated to seek non-U.S. suppliers in an effort to avoid U.S. export controls.

Licensing and other cooperative trade mechanisms such as manufacturing associate relationships play an important role in international trade. The GE turbine division, for example, says that its business related with manufacturing associates and licensees amounts to about $500 million annually.

American corporations may find acquisition of West European firms less attractive as host countries become reluctant to extend national treatment to U.S. subsidiaries. One company, Dresser, reportedly fears that its French subsidiary would be in greater danger of being nationalized if the U.S. attempts to prevent the latter from fulfilling its contract to supply compressors for the Yamal pipeline.

CLASSIFIED BY Eugene K. Lawson DAS/EWT/DOC

DECLASSIFY ON 1/28/88

CONFIDENTIAL

Approved For Release 2008/08/18 : CIA-RDP84T00109R000100080022-9

CONFIDENTIAL

The following provides a little more detail on the estimated cost for American firms:

I. Barring U.S. foreign subsidiaries from exporting oil and gas equipment.

Directly Affected:

Dresser Industries' French subsidiary with reported $45 million contract for compressors for Yamal pipeline;

Howmet Turbine Components Corporation's U.K. and French subsidiaries with $30 million each in contracts for components for turbines to Alsthom Atlantique;

and the following firms with subsidiaries which have been exporting petroleum equipment to the USSR (a comprehensive list is not available):

Baker (UK)
Camco (UK)
Cameron Iron Works (France)
Control Data (France)
Dresser (Canada)
FMC (France)
Grove Valve and Regulator (Italy)
Honeywell Control and Measuring Devices (Austria)
Hydril (Europe)
McEvoy (UK)
Rockwell International (Netherlands)
UOP (UK).
Others

These are the subsidiaries identified as having previously sold petroleum equipment to the Soviets; many other subsidiaries could be affected by extraterritorial application.

II. Barring Export of foreign products of U.S. technology transferred prior to December 30, 1981.

No comprehensive list of U.S. firms affected is available. Such a list would probably include the firms listed in I above, plus additional companies with foreign licensees that have exported to the U.S.S.R. such as

General Electric (turbines),
ARMCO (offshore rig structure),
Cooper (turbine components and compressors),
Perry Equipment (pipeline pigs),
Levingston (offshore rigs), and
Grove (valves).

CONFIDENTIAL